



ALASKA GROWTH CAPITAL BIDCO, INC. AND SUBSIDIARIES

(A Wholly Owned Subsidiary of
Arctic Slope Regional Corporation)

Consolidated Financial Statements

December 31, 2002 and 2001

(With Independent Auditors' Report Thereon)



701 West Eighth Avenue
Suite 600
Anchorage, AK 99501

JUN 18 2003

Independent Auditors' Report

The Board of Directors
Alaska Growth Capital BIDCO, Inc.

We have audited the accompanying consolidated balance sheets of Alaska Growth Capital BIDCO, Inc. and subsidiaries (a wholly owned subsidiary of Arctic Slope Regional Corporation) (Company), as of December 31, 2002 and 2001, and the related consolidated statements of income, stockholder's equity and cash flows, for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Alaska Fisheries, LLC (LLC), 49.4% owned investee company at December 31, 2001. The Company's investment in the LLC at December 31, 2001 was \$415,124, and its equity in loss of the LLC was \$359,524 for the year ended December 31, 2001. The financial statements of the LLC were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the LLC for 2001, is based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly in all material respects, the financial position of Alaska Growth Capital BIDCO, Inc. and subsidiaries at December 31, 2002 and 2001, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

February 28, 2003



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ALASKA GROWTH CAPITAL BIDCO, INC. AND SUBSIDIARIES

(A Wholly Owned Subsidiary of
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Consolidated Balance Sheets

December 31, 2002 and 2001

Assets	2002	2001
Cash and cash equivalents	\$ 1,444,899	3,774,769
Accounts receivable	336,992	202,044
Loans held for sale	556,549	343,645
Interest receivable	100,123	97,854
Prepaid and other assets	28,941	8,069
Loan servicing asset	73,649	—
Loans receivable, net of allowance for loan losses of \$436,656 and \$267,500 at December 31, 2002 and 2001, respectively (notes 2 and 3)	9,801,146	5,092,866
Deferred tax asset (note 7)	540,573	321,628
Assets held in trust (note 8)	509,268	216,219
Investment in Alaska Fisheries, LLC (note 5)	—	415,124
Property and equipment, net of accumulated depreciation (note 4)	336,890	57,447
	<u>\$ 13,729,030</u>	<u>10,529,665</u>
Liabilities and Stockholder's Equity		
Accounts payable and accrued expenses	\$ 924,256	493,601
Income taxes payable to parent (note 7)	1,514,057	1,734,399
Deferred revenue	2,594,400	2,059,200
Deferred compensation liability (note 8)	509,268	216,219
Minority interest	134,881	40,000
Loan servicing liability	67,263	—
Discount on retained portion of sold loans	207,399	—
Long-term debt (note 6)	—	896,369
Total liabilities	5,951,524	5,439,788
Stockholder's equity:		
Common stock	2,058,773	2,058,773
Additional paid-in capital	2,352,488	1,000,000
Retained earnings	3,366,245	2,031,104
Total stockholder's equity	7,777,506	5,089,877
Commitments and contingencies (notes 8, 9, and 11)	<u>\$ 13,729,030</u>	<u>10,529,665</u>

See accompanying notes to consolidated financial statements.

ALASKA GROWTH CAPITAL BIDCO, INC. AND SUBSIDIARIES

(A Wholly Owned Subsidiary of
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Consolidated Statements of Income
Years ended December 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Revenues:		
Grant and contribution revenue	\$ 2,369,327	2,725,800
Material transportation	1,376,859	—
Interest and fees on loans	1,038,310	377,102
Loan conversion credits, ASTF (note 6)	930,647	824,884
Gain on sale of loans	594,469	214,761
Interest and investment earnings	25,873	90,854
Consulting income	37,181	27,939
Other income	63,432	124,319
	<u>6,436,098</u>	<u>4,385,659</u>
Costs and expenses:		
Salaries and employee benefits	1,287,031	968,421
Cost of goods sold	1,059,610	—
Professional fees	276,492	88,306
Provision for loan losses (note 3)	124,362	246,498
Travel	89,910	38,588
Depreciation and amortization	79,688	36,482
Office operations	73,185	41,533
Equipment, rent and operations	70,795	45,751
Insurance	67,026	16,265
Bad debt expense	53,950	—
Supplies	45,158	46,102
Utilities	38,063	32,014
Dues, fees and licenses	23,849	23,321
Board and committee fees	23,400	16,800
Advertising and promotion	23,135	19,440
Professional development	22,632	20,983
Loss on sale of asset	11,242	1,155
Other	43,637	23,807
	<u>3,413,165</u>	<u>1,665,466</u>
Operating income	3,022,933	2,720,193
Other expenses:		
Interest	93,359	144,786
Minority interest	48,410	—
Income before income tax	2,881,164	2,575,407
Income tax expense (note 7)	1,167,596	1,056,174
Income from continuing operations	1,713,568	1,519,233
Discontinued operations:		
Loss from operations of discontinued operations net of income tax benefit of \$327,873 and \$144,529 for 2002 and 2001, respectively (note 5)	(487,731)	(214,995)
Gain from sale of vessel, net of income tax expense of \$73,478 (note 5)	109,304	—
Net income	\$ <u>1,335,141</u>	<u>1,304,238</u>

See accompanying notes to consolidated financial statements.

ALASKA GROWTH CAPITAL BIDCO, INC. AND SUBSIDIARIES
(A Wholly Owned Subsidiary of
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Consolidated Statements of Stockholder's Equity
Years ended December 31, 2002 and 2001

	<u>Common stock</u>	<u>Additional paid-in capital</u>	<u>Retained earnings</u>	<u>Total</u>
Balance as of December 31, 2000	\$ 2,058,773	1,000,000	726,866	3,785,639
Net income for 2001	—	—	1,304,238	1,304,238
Balance as of December 31, 2001	2,058,773	1,000,000	2,031,104	5,089,877
Capital contribution (note 7)	—	1,352,488	—	1,352,488
Net income for 2002	—	—	1,335,141	1,335,141
Balance as of December 31, 2002	\$ <u>2,058,773</u>	<u>2,352,488</u>	<u>3,366,245</u>	<u>7,777,506</u>

See accompanying notes to consolidated financial statements.

ALASKA GROWTH CAPITAL BIDCO, INC. AND SUBSIDIARIES

(A Wholly Owned Subsidiary of
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Consolidated Statements of Cash Flows

Years ended December 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Operating activities:		
Net income	\$ 1,335,141	1,304,238
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	79,688	36,482
Bad debt expense	53,950	—
Equity in loss from Alaska Fisheries, LLC	—	359,524
Noncash activity relating to discontinued operations	21,039	—
Equity allocable to minority interest	48,410	—
Loan conversion credits, ASTF (note 6)	(930,647)	(824,884)
Forgiveness of accrued interest expense (note 6)	34,278	144,786
Deferred taxes	(218,945)	(84,448)
Provision for loan losses	124,362	246,498
Loss on sale of assets	11,242	1,155
Changes in assets and liabilities that provided (used) cash:		
Interest receivable	(2,269)	83,323
Accounts receivable	(12,861)	1,094,025
Prepays and other assets	27,448	(1,356)
Accounts payable and accrued expenses	1,458,064	1,222,472
Deferred revenue	535,200	835,200
Net cash provided by operating activities	<u>2,564,100</u>	<u>4,417,015</u>
Investing activities:		
Purchase of property and equipment	(372,565)	(28,027)
Proceeds from sale of vessel, net of loan repayment (note 5)	1,460,000	—
Proceeds from minority interest	46,471	40,000
Investment in Alaska Fisheries, LLC, net of cash received (note 5)	(459,932)	—
Net increase in loans	<u>(5,045,546)</u>	<u>(1,761,013)</u>
Net cash used in investing activities	<u>(4,371,572)</u>	<u>(1,749,040)</u>
Financing activities:		
Principal payments on long-term debt	<u>(522,398)</u>	<u>—</u>
Net increase (decrease) in cash and cash equivalents	(2,329,870)	2,667,975
Cash and cash equivalents:		
Beginning of year	<u>3,774,769</u>	<u>1,106,794</u>
End of year	\$ <u>1,444,899</u>	<u>3,774,769</u>
Noncash activity:		
Forgiveness of income tax payable by Parent (note 7)	\$ 1,352,488	—

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

December 31, 2002 and 2001

(1) Operations and Summary of Significant Accounting Policies

(a) Operations

Alaska Growth Capital BIDCO, Inc. (Company), a wholly owned subsidiary of Arctic Slope Regional Corporation (Parent) was formed under the provisions of Alaska Statute 10.13 "Alaska BIDCO Act". The Company was incorporated on April 25, 1997, as a profit-oriented, market-disciplined private financial institution providing risk capital and management assistance to small and medium sized businesses in Alaska. Specifically, the Company is a financial entity that makes loans to private businesses that might not otherwise qualify for loans from a commercial bank. By statute, the Company is also authorized to make equity investments. Loans and equity investments made are restricted to entities within the State of Alaska.

As stated in the Articles of Incorporation of the Company, ten thousand (10,000) shares of Class C, no par value, nonassessable, voting common stock is authorized. As of December 31, 2002 and 2001, 2,058 shares have been issued to the sole stockholder, Arctic Slope Regional Corporation (ASRC or Parent).

(b) Estimates and Assumptions

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

(c) Principles of Consolidation

The consolidated financial statements include the accounts of the Company, its wholly owned subsidiary Alaska Fisheries, LLC and its 51% owned subsidiary Alaska Environmental, LLC. Alaska Fisheries, LLC was formed in 2000 to own and operate a catcher processor long line fishing vessel (note 5). Alaska Environmental, LLC was formed in December 2001 to provide environmental and trucking services in and around the State of Alaska. All significant inter-company balances and transactions have been eliminated.

(d) Cash and Equivalents

Cash and cash equivalents consist of highly liquid investments, maintained as part of the Company's cash management activities, which are readily convertible into cash and have maturities of less than three months from their date of purchase.

(e) Loans and Loan Fees

Loans are reported at their outstanding unpaid principal balances, adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loans are placed in nonaccrual when management believes the collectibility of the interest is doubtful. All interest accrued but not collected for loans that are placed on nonaccrual is reversed against interest income. The interest on these loans is accounted for

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Notes to Consolidated Financial Statements

December 31, 2002 and 2001

on the cash basis, until qualifying for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Loan origination fees, net of certain direct origination costs, are deferred and recognized over the life of the loan by a method approximating the level-yield method.

(f) Allowance for Loan Losses

The allowance for loan losses is a management estimate of the reserve necessary to absorb probable losses in the Company's loan portfolio. In determining the adequacy of the allowance, management evaluates prevailing economic conditions, results of regular examinations and evaluations of the quality of the loan portfolio by external parties, actual loan loss experience, the extent of existing risks in the loan portfolio and other pertinent factors. Future additions to the allowance may be necessary based on changes in economic conditions and other factors used in evaluating the loan portfolio. Additionally, the State of Alaska, as an integral part of their examination process, periodically reviews the allowance for loan losses. This agency may require additions to the allowance based on their judgments of information available to them at the time of their examination.

The allowance for impaired loans is based on discounted cash flows using the loan's initial effective interest rate or the fair value of the collateral for certain collateral dependant loans.

(g) Loans Held for Sale

Loans held for sale are carried at the lower of cost or estimated fair value in aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

(h) Property and Equipment

Property and equipment is recorded at the lower of cost or estimated fair value, and is depreciated over the estimated useful lives ranging from three to five years using the straight-line method.

(i) Investments in Affiliates

Investments in affiliates in which the company exerts significant influence, generally when the percentage ownership is greater than 20% but less than 50%, are accounted for on the equity method of accounting. The Company's prorata share of the earnings or losses is reflected in the consolidated statements of income.

(j) Revenue from Sales of Loans

Gains or losses resulting from sales of loans are recognized at the date the loans are sold if no significant contingencies exist.

(k) Loan Servicing Fees

The Company accounts for servicing rights in accordance with the provisions of SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*. SFAS No. 140 requires the Company to recognize servicing assets and/or servicing liabilities dependent on

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December 31, 2002 and 2001

whether the benefits of specific servicing contracts are expected to be more than adequate compensation to the Company for performing the servicing. Servicing assets are required to be evaluated for impairment. Any servicing asset or liability which results from the application of SFAS No. 140 is required to be amortized over the period of estimated net servicing income or loss.

(l) *Deferred Revenues*

Deferred revenues consist of advances from funding agencies. Advances from funding agencies are considered earned when performance goals and other restrictive covenants of the grants are achieved.

(m) *Earnings (Loss) Applicable to Minority Interests*

Minority interest in results of operations of the consolidated subsidiary represents the minority shareholder's share of the income or loss of the consolidated subsidiary. The equity of minority shareholder in consolidated subsidiary in the consolidated balance sheet reflects the original investment by this minority shareholder in the consolidated subsidiary, along with its proportional share of the earnings or losses of the subsidiary.

(n) *Contributions*

Contributions are considered earned when received unless there are significant donor imposed restrictions.

(o) *Income Taxes*

The Company files a consolidated return with its Parent; however, the Company records its own tax expense and liability as if it filed on a stand-alone basis, and the Company uses the asset and liability method of accounting for income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

(p) *Geographic Concentration and Alaska Economy*

The Company's growth and operations depend upon the economic conditions of Alaska and the specific markets it serves. The economy in Alaska is dependent upon the natural resources industries, in particular oil production, as well as tourism, government, and U.S. military spending. Any significant changes in the Alaska economy and the markets the Company serves could have a positive or negative impact on the company.

(q) *Reclassifications*

Certain reclassifications have been made to the 2001 balances to conform to the 2002 presentation.

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Notes to Consolidated Financial Statements

December 31, 2002 and 2001

(r) Financial Statement Presentation

The Company prepares its financial statements using an unclassified balance sheet as is customary in the commercial banking industry.

A classified balance sheet presentation would have aggregated current assets, current liabilities and net working capital, as follows:

	<u>2002</u>	<u>2001</u>
Current assets	\$ 5,537,179	7,614,776
Current liabilities	<u>2,505,576</u>	<u>2,228,000</u>
Excess of current assets over current liabilities	<u>\$ 3,031,603</u>	<u>5,386,776</u>

(2) Loans Receivable

The Company's loan portfolio is primarily comprised of floating rate commercial financing, secured by real estate or other similar collateral. The scheduled principal payments on the loan portfolio are as follows:

Year ending December 31:	
2003	\$ 2,529,102
2004	687,495
2005	638,678
2006	666,129
2007	596,045
Thereafter	<u>5,120,353</u>
	<u>\$ 10,237,802</u>

At December 31, 2002 and 2001, the recorded investment in loans that are considered to be impaired was \$243,217 and \$2,149,891, respectively, all of which were on nonaccrual basis. At December 31, 2002 and 2001, a specific allowance of \$75,000, was established against the recorded investment in impaired loans.

(3) Allowance for Loan Losses

The following is a detail of the allowance for loan losses:

	<u>2002</u>	<u>2001</u>
Balance as of January 1,	\$ 267,500	321,891
Provision for loan losses	124,362	246,498
Net recoveries (charge-offs)	<u>44,794</u>	<u>(300,889)</u>
Balance as of December 31,	<u>\$ 436,656</u>	<u>267,500</u>

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(4) Property and Equipment

The Company's investment in property and equipment at December 31, is as follows:

	<u>2002</u>	<u>2001</u>
Leasehold improvements	\$ 1,750	16,295
Transportation vehicles	323,220	—
Office equipment	138,959	108,772
	<u>463,929</u>	<u>125,067</u>
Less accumulated depreciation	<u>(127,039)</u>	<u>(67,620)</u>
	<u>\$ 336,890</u>	<u>57,447</u>

(5) Investment in Alaska Fisheries, LLC

In December 2000, the Company purchased 45% of Alaska Fisheries, LLC for \$550,000 in cash and the conversion of a \$250,000 outstanding loan receivable. During 2001, the Company increased its ownership interest to 49.4% under a member credit support agreement. Alaska Fisheries, LLC was organized for the purpose of catching, harvesting, processing and bringing to market ground fish caught in and around the Bering Sea and the waters off the Aleutian Islands. The LLC began operations in October 2000.

In June 2002, the Company purchased an additional 25% of the LLC for \$459,932, net of cash assumed. In December of 2002, the Company assumed the remaining shares of the LLC under a recapitalization agreement. Concurrent with the recapitalization agreement, the Company sold the primary long-term asset of the LLC for \$2,650,000, which resulted in a gain on sale of \$182,782. The LLC used the proceeds to pay off \$1,190,000 of long-term debt owed to the Company and \$522,398 of long-term debt owed to a financial institution.

Coinciding with the sale of the vessel, the LLC has essentially ceased operations and is in the process of winding down the business.

(6) Long-term Debt

Long-term debt of the Company consists of the following at December 31:

	<u>2002</u>	<u>2001</u>
ASTF loan due in 2009 bearing interest at variable rates (6.75% at December 31, 2001)	\$ —	896,369

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The Company's debt consisted of a loan from The Alaska Science and Technology Foundation (ASTF). The loan is convertible to a grant throughout the term of the loan through credits granted by ASTF. Credits to convert the loan, or a portion thereof, into a grant may only be earned for financial assistance provided to qualified businesses. Accrued interest on the loan can also be converted through such credits. All principal and accrued interest that is not converted is due and payable on June 1, 2009. During the years ended December 31, 2002 and 2001, the Company converted credits in the amount of \$930,647 and \$824,884 against the accrued interest of \$34,278 and \$144,786, respectively and loan principal outstanding of \$896,369 and \$680,098, respectively.

(7) Income Taxes

The Company files a consolidated tax return with its parent. The provision for income taxes for the years ended December 31 consists of the following:

	<u>2002</u>	<u>2001</u>
Current	\$ 1,132,146	996,093
Deferred	(218,945)	(84,448)
	<u>\$ 913,201</u>	<u>911,645</u>

Provision (benefit) for income taxes by operations is as follows:

	<u>2002</u>	<u>2001</u>
Continuing operations	\$ 1,167,596	1,056,174
Discontinued operations	(254,395)	(144,529)
	<u>\$ 913,201</u>	<u>911,645</u>

The actual income tax expense for 2002 and 2001 differs from the "expected" tax expense, computed by applying the U.S. federal corporate tax rate of 34% to income before income taxes, as follows:

	<u>2002</u>	<u>2001</u>
Computed "expected" income tax expense	\$ 764,436	753,400
State income tax, net of federal benefit	139,397	137,385
Other	9,368	20,860
	<u>\$ 913,201</u>	<u>911,645</u>

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The components of and changes for the years ended December 31 in the deferred tax asset are as follows:

	<u>2001</u>	<u>Deferred tax expense</u>	<u>2002</u>
Deferred tax assets:			
Deferred compensation	\$ 204,043	(134,865)	338,908
Allowance for loan losses	107,535	(68,001)	175,536
Other	10,050	(16,079)	26,129
	<u>\$ 321,628</u>	<u>(218,945)</u>	<u>540,573</u>

During 2002, the Parent forgave \$1,352,488 of income taxes payable, which was reflected as an addition to paid in capital.

(8) Retirement Plan

The Company participates in a qualified defined contribution 401(k) retirement plan (Plan) covering substantially all employees who have six months of service. The Plan is sponsored by ASRC. The Company matches employee contributions to the 401(k) Plan up to an annually determined percentage of each participant's compensation subject to statutory limits. For the year ended December 31, 2002 and 2001, the match rate was 4%. The amounts charged to operations for the years ended December 31, 2002 and 2001, were \$24,179 and \$13,228, respectively.

During 1997, the Company initiated a nonqualified plan (Plan) covering an executive of the Company. The Plan is designed to provide a long-term incentive program to such individual and promote the success of the Company. The Plan provides a cash benefit to the individual equal to 20% of accumulated earnings, as defined in the Plan. Benefit payments under the Plan will be made upon a change in control of the Company, or the individual's termination of employment, death or disability, whichever occurs first. The individual's interest in his benefit under this Plan shall vest over the course of four years from the effective date, at a rate of 25% a year.

The amounts charged to operations for the years ended December 31, 2002 and 2001, were \$333,785 and \$284,650, respectively.

(9) Operating Lease

During 1999, the Company entered into a lease for office space with an organization whose President is a member of the Company's Board of Directors. The term of the lease expired in October 2002. The Company subsequently moved into a building leased by the Parent and has a long term nonbonding commitment to lease office space for \$13,500 per month.

Lease expense on all operating leases of the Company was \$69,541 and \$45,074 for the years ended December 31, 2002 and 2001, respectively.

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(10) Related Party Transactions

(a) Central Treasury Banking and Financing

The Company has a central treasury account which is managed by ASRC. As a result, the Company cash balances are invested in interest bearing overnight funds daily. The central treasury also serves as an operating line-of-credit from which the Company is able to draw operating capital.

The Company earns or pays interest based on its actual daily balance in the central treasury. Total net interest income (expense) for the Company was (\$33,206) and \$90,854, during the years ended December 31, 2002 and 2001, respectively.

(b) Insurance

The Company participates in a self-insurance program with ASRC for workers' compensation, general and excess liability, auto, property and miscellaneous insurance coverage. The Company is charged workers' compensation insurance based on actual labor classifications of its employees. An allocation of general liability, other insurance coverage, and administration of brokerage fees is based on gross revenue. For the year ended December 31, 2002 and 2001, the Company incurred insurance expense of \$67,026 and \$16,265, respectively.

(11) Commitments and Contingencies

(a) Grants and Loans

Grants and loans received are subject to audit by funding agencies or their representatives. Amounts reflected in the consolidated financial statements as revenues in prior periods have generally not been audited by the funding agencies. Accordingly, adjustments of amounts received under grants and loans could result if the grants and loans are audited by such agencies. The Company believes it has complied with all grant and loan agreements.

(b) Loan Commitments

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These instruments are limited to lines-of-credit and loan commitments. The credit and market risks involved in issuing the lines-of-credit and loan commitments are essentially the same as those involved in extending loans to customers. Such transactions are made under the same terms, including interest rates and collateral, as those prevailing at the same time for comparable on-balance sheet transactions. Amounts of off-balance sheet commitments as of December 31, 2002 and 2001, are \$285,575 and \$169,912, respectively, for unused lines-of-credit. Loan commitments at December 31, 2002 and 2001, were \$813,000 and \$2,265,000.